Micro, Small and Medium Enterprises (MSMEs) have been recognised across the World by Governments, development institutions, think-tanks and academics as a key driver of economic growth and prosperity. Indeed, the economic backbone of developed nations has been MSMEs. In Europe alone, they comprise of 95% of the private sector and provide employment and income for billions. These enterprises have been responsible for driving growth and innovation in an increasingly integrated and competitive global economy. Their nimble size and flexible nature encourages adaptation and innovation to drastic changes in the market and operating environment. Feeding into the value chains of larger companies across borders, they obtain both competitive niches and support to grow and expand their operations progressively employing more capital and labour.

In Kenya, more than 80% of the private sector falls under the MSME bracket and these enterprises employ more than three-quarters of the labour force, but their economic output falls well short of the expectations these numbers set. MSMEs will be a key determinant of wealth creation in Kenya but there must be concerted efforts to address the various structural constraints facing them in order to reap the holistic potential they hold. This policy brief provides an overview of MSME development in Kenya, proposing a five-point policy framework from which to base transformative interventions on.
Micro, small and medium enterprises (MSMEs) are businesses that engage between 1 to 99 employees. MSMEs are businesses that engage between 1 to 99 employees. Formality of businesses increases with size of establishments since 21.8, 66.8 and 72.5 percent of micro, small and medium businesses were registered, respectively. More than 80% of businesses in Kenya are MSME.

There are about 7.41 million MSMEs in Kenya. There are about 7.41 million MSMEs in Kenya. The value of the MSME’s output is estimated at KSh 3,371.7 billion against a national output of KSh 9,971.4 representing a contribution of 33.8%.

92.2% of the licensed establishments in the MSME sector are micro establishments employing between 1 to 9 employees. 92.2% of the licensed establishments in the MSME sector are micro establishments employing between 1 to 9 employees.

Close to half of all MSMEs in Kenya are located in Nairobi County and within a 100 km radius of the capital.
MSME DEVELOPMENT TOWARDS A FIVE-POINT POLICY FRAMEWORK

OVERVIEW

• The importance of Micro, Small and Medium Enterprises to the economic livelihood of Kenyans is indisputable. MSMEs constitute about more than 80% of all businesses in Kenya and collectively employ close to 14.9 million people, constituting 78% of the entire labour force.
• There are about 7.41 million MSMEs in Kenya that collectively contribute about 34% of the country’s GDP.
• The majority of MSMEs (around 60%) are in the services sector, with the most of these operating in wholesale and retail trade, repair of motor vehicles and motor cycles.
• Despite this, the MSME sub-sector is built on a very shaky foundation. Over 85% of MSMEs in Kenya are unlicensed enterprises, with the vast majority of these falling under the category of ‘Micro’ employing between 1 to 9 people.
• Employment around unlicensed enterprises grew 5.9% from 12.5 million people in 2015 to 13.3 million in 2016
• Medium enterprises, employing between 50 to 99 employees, only account for 0.7% of total licensed enterprises in the country.
• 93.8% of unlicensed businesses have a monthly turnover of less than Ksh 50,000.
• Only 16.3% of licensed establishments have a net worth of above Ksh 1,000,000.
• 78.9% of unlicensed MSMEs do not have any records and more than 70% of their proprietors have no education or KCPE as their highest educational attainment.
• Around 400,000 MSMEs die annually with almost 90% of all MSME start-ups not being able to see their second birthday.
• Close to half of all MSMEs in Kenya are located in Nairobi County and within a 100 KM radius of the capital.

ANALYSIS & KEY TAKEAWAYS

• With a significant proportion of the Kenyan population involved in MSME activity, development policy must underscore improving the ability of MSMEs to survive, thrive and grow through the successive categories of micro, small and medium by progressively increasing output and employment.
• MSMEs in Kenya are largely in the informal sector of the economy pointing to a less than conducive business environment that places formal licensing and operation as more of an inconvenient cost than an incentive for growth. This issue is further reflected in the World Bank’s Ease of Doing Business rankings that places Kenya’s score for ‘starting a business’, ‘dealing with construction permits’ and ‘paying taxes’ parameters as significantly poorer than the global average.
• The sheer number of informal enterprises compared with their formal counterparts is certainly high in Kenya, but the disparity is consistent with other developing countries across the World. India for example, has fewer than 1.6 million registered MSMEs and approximately 26 million unregistered MSMEs.
• Formalisation of informal firms will enhance productivity and innovation which could increase their survival prospects and lifespan in the long run. This could be achieved through developing a supportive innovation ecosystem.
• The high death rate of MSMEs in Kenya emerges out of a multitude of issues around informality but can be fundamentally traced to the personal capacity of proprietors. The business and entrepreneurial skills of the owner significantly impact the ability of the enterprise to raise and soundly manage funds and make appropriate decisions that lead to growth and higher revenues.
• More than half of MSMEs in Kenya are engaged in low-end services. This sector is much less productive than agriculture or manufacturing and much more difficult to design structural interventions for. Furthermore, there is limited room for growth and expansion of both capital and labour in this sub-sector of the economy.
POLICY INITIATIVES THROUGH THE YEARS

The first post-independence initiative towards enterprise development in Kenya was through the Kenya Industrial Estates (KIE), established in 1967 with a role of promoting indigenous entrepreneurship by financing and developing small scale and micro enterprises.

The following concerted initiative was through Sessional Paper No. 1 of 1986 on Economic Management for Renewed Growth. This recognised the importance of Micro and Small Enterprises as a means of strengthening economic development. A major output of this drive was a taskforce paper entitled ‘Strategy for Small Scale and Jua Kali Enterprise Development in Kenya’. This paper was subsequently translated into a policy framework through the Sessional Paper No 2 of 1992 on Small Enterprises and Jua Kali Development. This was the first to exclusively address small enterprises, defining them as enterprises that employ between 1 & 50 employees.

MSME development as an independent policy priority first manifested itself through Sessional Paper No. 2 of 2005 on Development of Micro and Small Enterprises for Wealth and Employment Creation for Poverty Reduction. The paper highlighted key constraints facing MSMEs and proposed measures such as a Small Business Act which resulted to the Micro and Small Enterprise Act being passed by Parliament in 2012. This set up new rules and a dedicated institution (the MSE Authority) to support micro and small enterprise development in Kenya.

Vision 2030 further identifies MSMEs as a key growth driver for the achievement of Kenya’s development goal and has subsequently been incorporated into respective Medium-Term Plans.

More recently, the National Industrial Policy and the Kenya Industrial Transformation Programme (KITP) launched by the Ministry of Industry, Trade and Cooperatives, which seek to accelerate the development of industries, identified a key strategic pillar: ‘Develop Kenyan SMEs by supporting rising stars and building capabilities with model factories’.

Following the Kenya National Bureau of Statistic’s historic 2016 MSME Survey, crucial data and information on MSMEs in Kenya has become available paving the way for more comprehensive policy design. The MTP III concept note has subsequently recognised the importance of MSMEs and pledged to accord priority to the sector in development planning.

The ‘Big 4’ Priority Agenda has identified SMEs as a key overall enabler in the Governments efforts to deliver on food security, manufacturing, universal healthcare and affordable housing.

An SME National Masterplan has been identified as a key immediate deliverable to inform how best to leverage SMEs across the Big 4.

ANALYSIS & KEY TAKEAWAYS

- Enterprise development has always played a role in economic planning in Kenya but its importance has progressively increased since the turn of the century reflecting the global trend of shifting development priorities towards the role of the private sector in poverty alleviation strategies.
- By Sub-Saharan African standards Kenya has a large private sector which accounts for around 70% of formal employment. The private sector, however, suffers from deeply entrenched formal–informal dualism which is also a key feature of MSME development in Kenya. Larger businesses are more productive and produce the bulk of economic output while MSMEs that employ most Kenyans are characterised by lower-value activities, poor access to capital inputs and technology, and limited connectivity to supply chain opportunities.
- While the importance of MSMEs is becoming increasingly recognised, recent policy strategies and documents have primarily focussed on enterprises within the context of industrialisation. MSMEs, however, intersect many different sectors and developing a cross-sectoral policy framework to address issues holistically is essential.
- As private sector and enterprise development becomes an increasingly important Government priority, the role of Business Member Organisations (BMOs) in the policy process will be accentuated. BMOs are indeed the best placed institutions to articulate and drive policy options, seeking synergies between private interests and the macro development agenda.
A FIVE-POINT POLICY FRAMEWORK

With acknowledgement of the current state of MSME development as well as the evolution of policy towards this end, this section presents a five-point policy framework that is intended to operationalise the structured process of policy design aforementioned. The policy framework adopts working case studies, proven policy interventions, expert input and theoretical analysis to deliver a compact model from which to both articulate and think through policy issues.
1. INFORMATION & AWARENESS

Information is the keystone of effective decision-making and to set up and/or expand a business, one must have access to the requisite information and be aware of various opportunities and challenges that may arise. Information has always been somewhat of a competitive advantage in business, and those with the most and right pieces of information are able to act quicker and more decisively in the pursuit of opportunities. Expanding the availability and accessibility of information, therefore, constitutes an important step in alleviating some of the technical and monetary barriers that face enterprises in both start-up and operations.

**KEY AREAS**
1. Information & awareness on the steps required to start a business in the country.
2. Information & awareness on the economy, sectoral trends & opportunities.
3. Information & awareness on standards, technical requirements and procedures required to access various opportunities.
4. Information & awareness on various Government incentives, schemes and procurement opportunities.

2. LEGAL & REGULATORY ENVIRONMENT

A streamlined legal & regulatory environment for business is an inescapable aspect in ensuring both the seamless growth and effective operation of enterprises. For Kenya, business regulatory environment has been identified as the main constraint facing enterprise development; this is principally characterised by the number and cost of licenses and permits, bureaucratic process of business registration and high taxes.

These findings are further reflected through the World Bank’s ‘Ease of Doing Business’ report as well as the sheer number of unlicensed enterprises compared with their licensed counterparts. The latter point is a manifestation of the fact that in an economy with a less than conducive business environment, there are bound to be more unlicensed enterprises. Not only do unlicensed enterprises have fewer opportunities to grow, access credit and build capacity, they will not be able to access supply opportunities presented by Government and larger firms. The two most important and cross-cutting sub-variables for each of the last three of the issues identified are time & cost. Policy interventions must therefore focus on these issues by asking; how can we reduce the time and cost of this process for businesses?

**KEY AREAS**
1. Ease of Entry & Access to Markets
2. Business Registration
3. Licenses & Permits
4. Tax, Fines & Fees

3. ACCESS TO FINANCE

Finance is the lifeblood of any business and is required for the process of both starting a venture and maintaining operations. MSMEs find it particularly difficult to access finance due to factors including an inadequate number of assets to use as collateral, lack of satisfactory business plans and accounting reports, and insufficiently high levels of profitability or liquidity. This problem is particularly pronounced for informal MSMEs that are unregistered, as the process is perceived to be cumbersome. Additionally, regional differences in access to finance are also pronounced with Mombasa standing out as the most challenging region to access finance for informal sector firms. These constraints force MSMEs to move away from formal lending institutions and seek alternative sources of funding such as family/own funds, loans from friends and informal cooperatives. These alternative sources of finance are often insufficient to meet the required levels of capital for both start up and sustained operations. Policy interventions must therefore prioritise innovative ways of improving access to formal and lending institutions & mechanisms.

Notably, the introduction of the interest rate cap in September 2016 reduced credit growth not withstanding that the lending environment was already difficult. Private sector credit growth in Kenya fell from its peak of 25% in mid-2014 to 2% in October 2017, which is not attributable to one single event. This has adversely affected MSMEs opportunities to access finance.

The supply of and access to finance, however, is only one of the hurdles that face MSMEs for this particular point of the framework. As mentioned above, the main reason MSMEs move away from formal lending institutions & mechanisms is because of certain characteristics that they inherently possess such as low collateral and lack of accounting reports. Therefore, a second approach to addressing this point of the framework is in improving the viability of MSMEs to absorb capital from formal and innovative lending institutions. The challenge of access to finance must be addressed through successively solving these two hurdles.

**KEY AREAS**
1. Supply of finance from formal and innovative lending institutions.
2. Viability of SMEs to absorb finance.
The four preceding points of the framework have focussed on the ‘soft’ infrastructure required for enterprise development i.e. the institutions, regulations, capacity, processes and governance mechanisms. However, to effectively encourage the development of enterprises, ‘hard’ infrastructure projects must also be aptly designed and implemented. Infrastructure such as roads, pipelines, electricity transmission lines, market places and storage facilities are a key part of the overall development of an entrepreneurial economy. These directly influence the cost component of an enterprise’s activities as well as the commercial viability of various geographic regions, sectors and value chain opportunities. 

4. CAPACITY BUILDING

The best-practice passed on through capacity building in enterprise development primarily revolves around foundational business & entrepreneurial skills, focussing on issues such as financial literacy, leadership, internal management and decision-making abilities of the entrepreneurs. Indeed, the success of a business is inexorably linked with the capacity and skills of its proprietor.

Priorities under this point of the framework are therefore innately predisposed towards ensuring that prospective and established entrepreneurs have the requisite skills to start, run and expand their businesses. However, capacity building in a more holistic sense for enterprise development also encompasses the ability of businesses to meet specific technical, safety, quality and operational requirements that comprise standards for various opportunities presented by importing countries, Government and larger firms. This particular point of the overall framework must therefore address both the generic capacity building needs of MSMEs such as business & entrepreneurial skills as well as the more technical requirements needed to meet various export, procurement and supply standards.

As is clearly evident, this point of the framework is closely linked with the availability of information and indeed feeds into the ability of proprietors to keep sound records and financial accounts thereby improving their access to finance.

**KEY AREAS**
1. Business & Entrepreneurial Skills
2. Capacity to meet standards
3. Business support systems

5. SUPPORTING INFRASTRUCTURE

When it comes to enterprise development, large infrastructure projects such as roads and more basic infrastructure requirements such as electricity and water provision are equally important. The latter is particularly important for MSMEs with their cost and availability having a significant influence on business competitiveness.

**KEY AREAS**
1. Large Infrastructure (Roads, Market Places, Storage Facilities, Ports etc.)
2. Basic Infrastructure (Electricity, Water, ICT Services etc.)
REFERENCES & FURTHER READING


ABOUT POLICY BRIEFS
The Policy Briefs provide a summary and concise analysis of topical economic issues in Kenya to inform dialogue and decision-making. They are developed in a collaborative process with both industry players and academia through a rigorous process of research, analysis and peer-review.

ABOUT KBG
The Kenya Business Guide (KBG) is a think-tank that seeks to support the improvement and strengthening of the business environment in Kenya by providing access to information on key features of both the private and public-sector prerequisites in the effective functioning of business.

ABOUT KNCCI
The Kenya National Chamber of Commerce and Industry (KNCCI) is a long-established business membership organization with a countrywide county network in Kenya. It’s core mandate is promoting, protecting and developing the interest of its members and the entire business community by fostering a business enabling environment.

ABOUT SBS
The Strathmore Business School (SBS) is the graduate business school of Strathmore University. Based in Nairobi, it offers MBA and other postgraduate programs, as well as producing research on public policy and economics through the Strathmore Institute of Public Policy and Governance (SIPPG).

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